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728257—47

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. ——

MARION H. ALLEN, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

THE FIRST NATIONAL BANK & TRUST COMPANY IN MACON, AS EXECUTOR UNDER THE LAST WILL AND TESTAMENT OF MRS. FLORETTA S. ULMAN (MRS. E. ULMAN), DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Acting Solicitor General, on behalf of Marion H. Allen, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit entered in this case.

OPINIONS BELOW

The material portions of the stipulated facts (R. 15–41) and the conclusions of law (R. 42–43) of the District Court are reported at 65 F. Supp. 128. The opinion of the court below (R. 49–50) is reported at 157 F. 2d 592.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 25, 1946. (R. 50.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the amount received by the life beneficiary for the surrender of her right to income of a testamentary trust is taxable in full as ordinary income under Section 22 (a) of the Revenue Act of 1938, or whether it may be treated as the proceeds of the sale of a capital asset under Section 117 of that Act.

STATUTE INVOLVED

The pertinent statutory provisions are set forth in the Appendix, *infra*.

STATEMENT

The facts, which were developed by a stipulation (R. 15–18) and exhibits attached thereto (R. 19–41) and were found by the Trial Court to be as stipulated (R. 42), may be summarized as follows:

This is an action brought by the respondent as executor of Mrs. Floretta S. Ulman (hereinafter sometimes referred to as the taxpayer) for the recovery of $7,647.50 paid as additional federal income tax, and interest, for the year 1938 as the

result of the addition by the Commissioner to the gross income of Mrs. Ulman of the sum of $35,000 received by her in that year, as hereinafter brought out. (R. 5–8, 15.)

The taxpayer's husband, Emanuel Ulman (hereinafter sometimes referred to as the testator) died in 1929, leaving a will (R. 24–29) in which, amongst other things, he provided that his residual estate be held in a trust. From the income of the trust $125 a month was to be paid to his brother Louis Ulman for life, the premiums upon a certain insurance policy on his brother's life were to be paid, and the balance of the income was to be paid for life to his wife, the taxpayer. The trust was to terminate after the death of the wife and brother, the corpus of the trust then going to the testator's nephew, George Birkenstein. (R. 15–16, 26–27.)

In 1938, a dispute arose between the taxpayer and George Birkenstein as to whether the premiums paid by the trustees in the purchase of securities should be paid out of income of the trust, as contended by Birkenstein, or whether they should be charged to corpus, as claimed by the taxpayer. The trustees applied to a state court in Georgia for instructions (R. 19–23), and while the controversy was under consideration and pending in that court, the taxpayer and Birkenstein entered into an agreement (R. 33–39), which was also signed by the trustees (R. 39). By an amended pleading in the state court action

(R. 29–33), the agreement was submitted for approval to the court, which later approved it and incorporated it in its decree in the case (R. 39–41), the decree being consented to by all of the parties, including the taxpayer (R. 41). The agreement and decree resulted in the taxpayer selling her entire interest in the trust to Birkenstein for $35,000 and in the termination of the trust, the corpus being turned over to Birkenstein. (R. 16.)

The agreement provided that Birkenstein should pay to the taxpayer the sum of $35,000 in cash, in consideration of which the taxpayer "will execute a conveyance to * * * Birkenstein, conveying to him all her right, title and interest" (R. 36) in the trust, and further provided that Birkenstein would purchase an annuity for the payment of the premiums on the insurance policy on the life of Louis Ulman, and for the payment of $125 a month to Louis Ulman for life (R. 36–37), and that thereupon (after the fulfillment of other conditions not here material) the corpus of the trust should be turned over to Birkenstein (R. 38). The state court in its decree held that the parties "have the right to make the contract * * * and terminate the trust", further stating (R. 40) "that all parties have consented to the termination of the trust estate, and discharge of the Trustees, except Louis L. Ulman for whom adequate provision is being made" (by the annuity above mentioned). With respect to the

payment of $35,000 to be made to taxpayer, the decree further stated that (R. 41) "upon the payment to the said Mrs. Floretta F. Ulman by the said George Birkenstein of the amount agreed * * * any and all rights of the said Mrs. Floretta F. Ulman in and to said estate * * * shall cease and determine".

During the life of the trust the taxpayer received taxable[1] income therefrom aggregating $11,830.86 from 1929 to 1937, inclusive. Under Treasury Regulations 105, Section 81.10, the value of the taxpayer's life estate on the date she acquired her right thereto was $34,136.92, while, because of subsequent enhancement in value of the trust assets, on the date of the conveyance from the taxpayer to the remainderman, its value, based upon her age and the age of Louis Ulman on that date, was $35,060.89. (R. 16–17, 18.)

In her return for the year 1938, the taxpayer reported a net income of $2,580.06, upon which she paid a tax of $52.88 (R. 10), apparently not including in her income any part of the $35,000 received by her from Birkenstein in 1938. The Commissioner in his determination added the entire $35,000 to the taxpayer's income for that year, upon the theory that it was includible as ordinary

[1] The word "taxable" contained in the original stipulation of facts between the parties was erroneously omitted in the printing of the record in the lower court. (R. 16.) See 65 F. Supp. 128, 129, where the District Court proceedings are reported.

gross income under Section 22 (a) of the statute. (R. 10, 18.) After payment of the resultant additional tax and interest, a claim for refund (R. 9–12) was filed, and, later, the present action was instituted by the respondent, seeking refund and recovery upon the ground (1) that the $35,000 payment received by the taxpayer constituted the payment of her inheritance under the will of her husband and was not taxable income, and (2) if not the payment of her inheritance, it was the proceeds from the sale of a capital asset, which sale did not result in a gain to the taxpayer because the value of her estate was equal to or greater than the amount she received (R. 8, 11–12).

The District Court held that the amount received by the taxpayer constituted the proceeds from the sale of a capital asset, and further held that there was a capital gain of $863.08 upon the sale, 50 percent of which should have been taken into account in computing taxable income of the taxpayer, but that, although the taxpayer failed to include the taxable capital gain in her income, any claim for additional taxes by reason thereof was barred by the statute of limitations at the time the additional assessment was made. (R. 42–43.)[2] Accordingly, the District Court entered

[2] In the appeal to the court below, the Collector, in addition to contending that the entire $35,000 was taxable as ordinary income, also argued that in any event the District Court had erred in concluding upon the record in the case that

judgment in favor of the respondent for the amount sued for, with interest. (R. 43–44.)

The court below affirmed. (R. 50.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In failing to hold that the amount of $35,000 received by the taxpayer in satisfaction of her life interest in the income of the trust constituted ordinary income taxable in full under Section 22 (a) of the Revenue Act of 1938.

2. In holding that the amount in question may be treated as the proceeds of the sale of a capital asset under Section 117 of that Act.

3. In affirming the judgment of the District Court.

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the statute of limitations barred the collection of any additional tax with respect to the capital gain it had determined to be taxable to the taxpayer. However, the court below, in its opinion (R. 49–50) did not mention this point, on which the District Court was clearly in error. Since the alleged bar of the statute of limitations was not set forth as a ground either in the claim for refund (R. 9–12) or in the complaint (R. 5–8), there could be no recovery *upon that ground* by the respondent in this action of any part of the additional assessment or interest thereon sought to be recovered. *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269. Obviously, the alleged bar of the statute of limitations must be stated in the claim for refund, alleged in the complaint, and established by the evidence just as any other ground for the recovery of taxes alleged to have been erroneously or illegally collected. Here, not only was the alleged bar not set forth as a ground in the claim or in the complaint, but also the record completely fails to establish it.

4. In failing, in any event, to reverse the judgment of the District Court insofar as that judgment failed to take into consideration the amount of capital gain determined to be taxable to the taxpayer.

REASONS FOR GRANTING THE WRIT

The primary question involved in this case is the same as that involved in *McAllister* v. *Commissioner*, 157 F. 2d 235 (C. C. A. 2d), now pending on the Government's petition for certiorari, No. 848, present Term. A writ of certiorari should be granted in the instant case for the reasons set forth in that petition.

CONCLUSION

The petition should be granted.

Respectfully submitted.

GEORGE T. WASHINGTON,
Acting Solicitor General.

JANUARY, 1947.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusion from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, bequests, and devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining

gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property:* The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this title—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l);

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 942

MARION H. ALLEN, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

THE FIRST NATIONAL BANK & TRUST COMPANY IN MACON, AS EXECUTOR UNDER THE LAST WILL AND TESTAMENT OF MRS. FLORETTA S. ULMAN (MRS. E. ULMAN), DECEASED

BRIEF FOR RESPONDENT OPPOSING THE GRANT OF THE WRIT OF CERTIORARI

The claim of the Commissioner that to treat a bona fide sale by a life tenant of his life estate as a sale of a capital asset opens up tax avoidance possibilities is spurious.

There can be no tax avoidance when only the gain arising from the sale of the life estate is taxed. The income arising from those proceeds is taxable, and upon the death of the life tenant the amount received from the sale of the life estate becomes part of the estate of the decedent subject to be taxed while the life estate would not.

Possibly the Commissioner is thinking about partial assignments by a life tenant of the income for short periods of time, but most emphatically that is not the

case at bar. The sale here was at arm's length, absolute and irrevocable, of the life tenant's entire interest.

To tax the entire proceeds derived from the sale of the life estate as ordinary income is double taxation—a tax on the gain and another tax on the return of the capital—and to treat these proceeds as ordinary income under the guise that such proceeds constitute the anticipation of income is a fraud upon the 16th amendment to the Constitution.

The assertion so assiduously made that the proceeds derived from the sale of a life estate is no more than a substitute for future payments is shocking to one's conceptions of realities.

On occasions this Court has found it necessary to ignore some of the common law niceties with respect to conveyances and estates. But never has any doubt been cast upon the verity of a life estate.

> See *Helvering v. Hallock*, 309 U. S. 106, p. 117-118.

Therefore, it is no accident that Congress, the Commissioner and the courts have treated a life estate as a capital asset and that there can be no income from the sale thereof until the basis of the life estate is returned.

There is no difference in the income received from a life estate and the income from a fee simple estate. And why should there be a difference in the proceeds derived from the sale of a life estate and the sale of a fee simple estate.

In the Gavit case, relied on so strongly by the Commissioner, Justice Holmes made it perfectly clear that it

was the income which was taxable and not the corpus which produced the income.

The Blair case, which the Commissioner treats lightly, completely settles the issue.

> "The will creating the trust entitled the petitioner during his life to the net income of the property held in trust. He thus became the owner of an equitable interest in the corpus of the property . . . The interest was present property alienable like any other, in the absence of a valid restraint upon alienation."
>
> *Blair v. Commissioner*, 300 U. S. 5 (6), p. 13.

In the Schaffner case, 312 U. S. 579, Chief Justice Stone reaffirmed this doctrine, saying:

> "Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case." (p. 583)

Any other treatment of the proceeds arising from the absolute sale of a life estate would destroy our historical concept of property.

When one sells a life estate the seller has parted with the title to his estate. He has not received income—he has received the proceeds from the sale of property.

The Hort case is not at all in point. There wasn't the slightest characteristic of a sale or transfer in that

transaction. It was nothing more than an amicable adjustment of the breach of a contract. It is the same transaction as where A contracts to buy from B six months hence 1,000 bales of cotton at ten cents per pound, but when the time for delivery arrives, cotton being five cents per pound, A pays B $10,000 to be released from his contract. There is not present any element of a genuine sale in such a transaction. The true effect of what is done is the settlement of a contract—nothing more and nothing less. And that is all there was in the Hort case.

But that is not what happens when a life tenant or life beneficiary makes a genuine sale of her life estate.

Finally, the position of the Commissioner is not only inconsistent with the statute and the decisions of this Court but is inconsistent with his own previous position. In the case of *Harman v. Commissioner*, 4 T. C. 335, the Tax Court said:

> "The first issue presented for decision is the right of each of the petitioners to deduct from their income . . . the amount of a loss incurred upon the sale of certain coal lands which they inherited for life under the will of their father. This issue suggests the following questions: (1) Was the loss that of the individual taxpayers or that of the estate of W. F. Harman? (2) What is the amount of the loss? (3) Is the loss capital or ordinary?"

The Tax Court, on page 347, held:

> "Therefore, we hold that petitioners' life estates in these coal lands are capital assets."

The Commissioner acquiesced in this decision. (1945 I.R.B., p. 3)

In conclusion, respondent avers that the contention of the Commissioner is unconscionable. The Government can suffer no prejudice by taxing only the gain on the sale of the capital asset in that the income derived from the proceeds of the sale of the life estate will, in the end, produce the same identical revenue for the Government as the life estate and the transmission of the fee simple estate by gift or death will likewise be taxable. That ought to be enough.

Respectfully submitted,

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